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Supreme Court of the United States

OCTOBER TERM, 1965

ALBERT A. LIST,

Petitioner,

v.

LOUIS C. LERNER, *et al.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY TO MEMORANDUM FOR THE UNITED STATES AS *AMICUS CURIAE*

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PETITIONER'S REPLY TO MEMORANDUM FOR THE UNITED STATES AS *AMICUS CURIAE**

This is a reply to the U. S. memo filed herein in response to the Court's order of May 17, 1965, inviting the Solicitor General to express the views of the United States.

The Government's view that the case although decided wrongly, should not be reviewed by this Court is unjust to petitioner, illogical, ignores the recognized importance of the issue, and is based on a clearly erroneous construction of the record

General Comment. Despite the careful phrasing and a studied attempt at impartial, dispassionate analysis, the U. S. memo bring into sharp focus the fundamental issue presented by the Petition. Petitioner urges that the decision

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* Herein referred to as "U. S. memo".

below was wrong, and the Court of Appeals should have reversed the Trial Court or at the least ordered a new trial controlled by proper legal principles. The U. S. memo agrees the decision below was wrong but appears to express a subjective impression that some other case might better lend itself to a dilineation of the admittedly important legal issue. It might have been more appropriate if the U. S. memo had said simply and unequivocably—the decision below was wrong but the Commission is waiting for a more suitable showcase. This is truly the heart of the Solicitor's argument—couched at times in the words "we believe" and at other times as "the Commission believes" to such an extent that seemingly, the Commission and the Solicitor General have differing opinions on some of the important aspects of the case.

It is interesting to note that in expressing the view which this Court sought and might reasonably have expected to be an all encompassing and objective, there is no one single mention, citation or discussion of the opinion of this Court in *S.E.C.* v. *Capital Gains Research Bureau,* despite petitioner's clear and heavy reliance thereon. This Court's opinion in *J. I. Case Company* v. *Borak* is relegated to passing reference in a footnote. It might be asked whether this is the kind of objectivity which can be expected from the Government's chief legal officer when such objective discussion was specifically requested.

The Government Agrees with Petitioner's Contention That the Decision Below Was Wrong

Agreeing with petitioner's analysis of the holding below, the U. S. memo (p. 3) concludes that the fundamental legal principles enunciated below were:

> ". . . a purchaser of securities may violate Rule 10b-5 while maintaining complete silence; but that in order to recover damages for such violation the

> seller must establish (1) that knowledge of the undisclosed facts would have 'influenced [him] to act differently' (referred to by the court as 'reliance') and (2) that 'a reasonable investor' would have been influenced by the disclosure (referred to by the court as 'materiality')."

In asserting, however (at p. 5) that the Court of Appeals correctly decided the most important interpretive issue, the U. S. memo begs the question. True, the Court of Appeals may have paid lip service to the general principle which compels disclosure by a corporate insider of all information he has acquired before purchasing stock in his corporation. It was in the application, however, of that general principle to the case at bar that the court below erred—and this is conceded in the U. S. memo.

It is not merely enough to state the obvious—i.e., disclosure was required by respondents. That the Court below did so state does not cure the vice inherent in the decision. The U. S. memo states clearly—as petitioner contends—

> ". . . the court of appeals erred in evaluating the separate effect of each non-disclosure, rather than evaluating their combined and cumulative impact." (p. 9)
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> • • • • • • •
>
> "We thus conclude that the court of appeals here improperly applied the governing standard for determining whether the non-disclosures were material and injured the seller." (pp. 9-10)

Moreover, as the U. S. memo says of an integral part of the decision below:

> "Framing the test in terms of 'reliance,' however, is not particularly helpful when dealing with a case of

complete non-disclosure. For it is difficult to see how a seller fairly can be said to have 'relied' upon something he never even knew about, and this analysis leads to such confusing concepts as 'the negative of the fact undisclosed.' The appropriate inquiry, we believe, is whether the non-disclosure by the buyer caused injury to the seller. (p. 7)

"The court of appeals enunciated the test as 'whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact'.

In a case where the transaction was personally negotiated between the parties, this may be an appropriate basis for determining whether the seller was injured by the non-disclosure. But it would seem too restrictive a standard in situations where the element of personal negotiations was lacking and the purchases were routine transactions on a securities exchange or in the over-the-counter market. * * * It is unclear whether the standard which the court of appeals announced would permit a seller to recover in such circumstances." (p. 8)

Thus the U. S. memo agrees with petitioner that the Court below erred in the two most significant areas presented to it for decision.

In summary, therefore,

A. The U. S. agrees disclosure was required by the respondents of something (U. S. memo, pp. 6-7).

B. Standing alone, a requirement of disclosure is meaningless. As the U. S. memo says (p. 7):

"Once such a violation is established, however, there is the further question of what causal connection the seller must show between the violation and his decision to sell in order to recover damages based on such violation."

Consequently, it is the sheerest sophistry to argue as does the U. S. memo (p. 5) that—

> "the case as presented to this court primarily involves the determination of factual questions".

C. The Court below did not follow these proper principles in answering the very questions which the existence of a situation involving the general duty of disclosure requires be answered.

> Question 1—What the seller must show in order to recover damages based on a conceded violation. The memo says, the test of 'reliance' used by the court below is not proper, the appropriate inquiry is injury (p. 7).

As to this, no matter how the U. S. memo tries to excuse the decision below, it must and *in fact does conclude* with regard to the test enunciated by the Court of Appeals (pp. 7-8);

> "framing the test in terms of 'reliance', however, is not particularly helpful when dealing with a case of complete non-disclosure. * * * it would seem too restrictive a standard in situations where the element of personal negotiation was lacking and the purchases were routine transactions on a securities exchange or in the over-the-counter market."

Accepting the Government's view of the proper nature of the inquiry—*Was petitioner injured?* we agree with the Government's conclusion that "In any realistic sense, therefore, they were injured by the buyer's nondisclosure and should be permitted to recover" (p. 8).

> Question 2—Should each non-disclosure be viewed separately or cumulatively, and in combination. As

> to this, the U. S. memo concedes—"we believe that the Court of Appeals erred in evaluating the separate effect of each non-disclosure, rather than evaluating their combined and cumulative impact" (p. 9).

Despite the inescapable conclusion which the Solicitor General's own logic compels that he reach and which he does reach, albeit reluctantly, viz. the decision below was wrong—he nevertheless suggests the case at bar is not an appropriate one for this Court to entertain.

This advice is predicated on three premises, all demonstrably erroneous: 1) The case is limited to its peculiar facts; 2) the case is not important; and 3) the Petition may not have raised the key questions.

The Within Case is No More Nor Less Controlled By its Facts Than Any Other Case Involving Section 10(b).

As the U. S. memo says (p. 5):

> "The issues have many ramifications, and they may arise in a wide variety of factual situations."

This statement is inconsistent, however, with the later expressed view of the memo that because the case involves factual matters, this Court should not grant certiorari. As the Government so obviously recognized, every case arising under Section 10(b) involves varying facts. It is petitioner's contention that guide lines ought to be set and set now by the Supreme Court to control the future cases which arise under widely varying facts and of which there have recently been a proliferation.

The Issue Here Presented is Important Enough to Require Decision by This Court.

As the U. S. memo says of the issues here involved (p. 5):

> "They have become more important in recent years, since Section 10(b) and Rule 10b-5 have been relied on with increasing frequency by the Commission to prevent deceptive activities by purchasers of securities and by private parties to secure redress for such activities. This Court has not yet interpreted these provisions, and a decision by it would provide helpful guideposts in the development of this important area of the law."

The Government also recognizes that the issue here presented has "many ramifications".

The importance of a decision in this case to the investing public and securities experts generally, is apparent from a recent article which appeared on the first page of the Wall Street Journal for July 14, 1965, wherein it is said among other things:

> "It's true, that neither Rule 10B-5 nor its underlying securities law makes any specific provision for private suits to recover damages. But in recent years the rule and the law have begun to acquire the courts precedents needed to make them potent weapons in the hands of disgruntled investors. Among other things, a 1964 Supreme Court decision is giving encouragement to the stockholder cause.
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> • • • •
>
> "Until now, 10B-5 has been a sleeping giant; we haven't known how far the courts will go in applying the fair standards for securities transactions set by the SEC • • •.
>
> "Especially important to angry stockholders is a series of Federal Court decisions which gradually have been

> clearing away the thicket of legal uncertainty surrounding the use of Rule 10B-5 in private suits.
>
> • • • •
>
> "Currently there's special interest among securities law experts in the possibility of a High Court ruling in a suit titled *List* v. *Fashion Park, Inc., et al.*, a case that directly involves Rule 10B-5."

The importance of the case is even more graphically demonstrated by an article beginning at page 29 of the August 6th issue of LIFE which is captioned: "SEC v. Texas Gulf Raises Sticky Questions." In the article the author says of the *Texas Gulf Sulphur* case, which is bottomed on the same statute involved and involves the same principle and theory as the within action:

> "The issues in the suit go right to the heart of one of the thorniest ethical questions in the field of investment; to what extent should a businessman be allowed to profit, in private stockmarket dealings, from knowledge of a company's affairs which he has and outside investors do not."

This is prescisely the question presented by the within petition.

Clearly, whether or not the Solicitor General and the Commission are aware of it, the investing public and authors in the field realize the significance and importance of the issue presented by this petition.

That there may be indeed some difference of opinion as between the Solicitor General and the staff of the Commission may be inferred from the use in the U. S. memo at the bottom of page 5 of the expression "the Commission believes", whereas in the immediately preceding sentence and elsewhere throughout the memo appears the expression "we believe". This is a significant difference because in the very sentence in which the reference is made to the

beliefs of the Commission as distinguished from those of the United States, appears the further expression—"it does not believe that [the erroneous rulings of the Court of Appeals] if allowed to stand would have a sufficiently significant impact upon the administration of the Securities Exchange Act." The "it" refers to the Commission.

Whether or not the decision below might have a significant effect on the administration of the Securities Exchange Act *by the Commission* is not the sole issue as demonstrated from the avid interest of commentators referred to above. In addition, the investing public, financial commentators, securities law experts and the public generally, are vitally concerned with and interested by the issue which this case raises. An early decision by this Court would go far to settle the uncertainty which according to the Wall Street Journal and Life has already given birth to "a flurry of stockholder suits."

The Petition Did in Fact Raise the Issues Which the United States Memo Infers Were Not Raised

Although agreeing with petitioner that the "court of appeals here improperly applied the governing standard for determining whether the non-disclosures were material and injured the seller" the U. S. memo at two places (pp. 9 and 10) suggests that the Petition failed to contend that petitioner would not have sold if he had the information which concededly the respondents were required to disclose. This suggestion in the U. S. memo is absolutely incorrect. The Petition clearly and undeniably raises the point. Thus at page 8 of the Petition appears the following assignment of error:

> "The Court of Appeals erred in adopting the Trial Court's finding (1) That List would have sold even if he had the information that one of the buyers was a director of Fashion Park, and (2) that the undisclosed

resolution that Fashion Park be sold or merged was not a material fact (269a)."

Petitioner testified (pp. 56a and 57a of Appendix of main brief in the court below):

"Q. You did know that Mr. Lerner was a director of Fashion Park, didn't you? A. Yes.

Q. You got that from the reports of the company, didn't you? A. That's right, yes.

• • • •

(288) Q. At the time that you agreed to sell your stock on or about the 17th day of November, were you familiar in any way with that resolution of November 4th? A. No, I was not.

Q. Had you been informed by anybody that such a resolution to sell or merge the company had been adopted by the board of directors on November 4th? A. I had not.

Q. Now, Mr. List, if you had known that Mr. Lerner was one of the potential buyers of your block of stock, at the time that you sold—that you agreed to sell, would you have agreed to sell your stock at $18, or at 18.50?

• • • •

A. I would not have sold the stock.

• • • •

Q. If you had known that a member of the board of directors of Fashion Park, Inc. was the potential (289) buyer of all or part of that block of stock, would you have consented to its sale for $18.50?

• • • •

A. I would not have sold my stock.

Q. If you had known that at the time—if you had known on November 17th, when you agreed to sell your block of stock at $18.50, that prior thereto and on

November 4 a resolution had been adopted by the board of directors of Fashion Park, unanimously adopted, to merge or sell the company, would you have agreed to sell your stock at $18.50 a share?

* * * *

A. I would not.

* * * *

A. I would not have sold my stock.

Q. Now, if you had known on November 17th, when you agreed to sell your stock at $18.50, that a partner of Hentz & Company, stock brokers, was buying part of that stock, would you have agreed to sell your stock for $18.50 a share?

* * * *

(290) Q. Would you have sold your stock? Should I repeat the question to you? A. No. If it was pointed out to me that a partner in the firm was personally purchasing the stock, I would not sell it."

There was not one single bit of testimony or one scrap of evidence to contradict petitioner's testimony; and assuming *arguendo* that there was a finding that petitioner might still have sold had he known the undisclosed facts, this finding was without any support whatsoever in the record and was clearly erroneous.

Conclusion

The writ should be granted for the following reasons:

1. The decision below is in conflict with the purposes of the Federal securities laws and the canons of construction of these laws as set forth by this Court in its *Borak* decision and in its *Capital Gains Research* decision and by the Commission in the *Cady, Roberts* release.

2. The decision below affects an area of securities transactions of increasingly great financial importance and of frequent occurrence. There is substantial conflict in principle between the decision below and the decision in other circuits as well as the decisions of this court.

3. A decision by this Court is needed to clarify the purposes of the Federal securities laws and the import of the language of Rule 10b-5.

4. To permit a clearly erroneous decision to stand unchanged denies petitioner his equal rights under law and makes a mockery of the administration of justice.

Respectfully submitted,

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